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Securing Policy Space for Clean Energy under the SCM Agreement: Alternative Approaches

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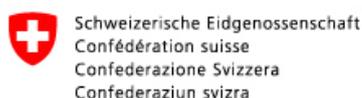
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ABSTRACT

The case for policy space for clean energy policies has to be made in terms of the political- and other challenges of adopting ideal or optimal policies to ensure that the relative pricing of clean and dirty energy reflects climate and other environmental externalities. It is unlikely that a consensus could be found among World Trade Organization (WTO) Members to carve out clean-energy policies from Subsidies and Countervailing Measures (SCM) disciplines. This paper suggests alternatives that do not require formal amendment of the SCM Agreement.

The focus on agreement on the interpretation and application of the SCM Agreement rather than its amendment arises, at least in part, from the open-ended nature of the key concepts for determining whether subsidies are susceptible to challenge under the SCM Agreement, or susceptible to WTO legal trade remedy action. Since it is extremely difficult to obtain agreement on amending existing WTO treaties, especially outside a trade round, conceiving, at least in the short and medium term, the adjustment of the SCM Agreement through an interpretive understanding rather than an amendment makes sense. An alternative, or perhaps even a complement, to an interpretive understanding could be a waiver for existing clean-energy policies pursuant to Article IX (3) of the WTO Agreement.

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LIST OF ABBREVIATIONS

AB	Appellate Body
APEC	Asia-Pacific Economic Cooperation
DSU	Dispute Settlement Understanding
EGS	Environmental Goods and Services
MFN	most favoured nation
SCM	Subsidies and Countervailing Measures
TBT	Technical Barriers to Trade
TRIMs	Trade-Related Investment Measures
TRIPS	Trade-Related Aspects of Intellectual Property Rights
WTO	World Trade Organization

INTRODUCTION

This paper considers concrete options for addressing the need for policy space under the World Trade Organization (WTO) Subsidies and Countervailing Measures (SCM) Agreement for clean energy. Essentially all WTO Members that produce clean-energy products maintain government policies that address the (albeit narrowing) gap between the cost of clean energy and that of dirty (fossil fuel-generated) energy. These range from production subsidies for clean energy technologies (often with domestic content conditions) to feed-in tariff programs to consumer subsidies. Some of these policies, over the last two years, have been the subject of an increasing number of trade disputes, whether trade remedy actions or challenges in WTO dispute settlement. The decision of the Appellate Body (AB) in the *Canada–Renewable Energy* case made it clear that many domestic content requirements or conditions are not compatible with the WTO law as written. At the same time, the AB suggested, in its analysis of “financial contribution” and “benefit” under the SCM Agreement that clean energy markets, as structured through government policy, may operate in different ways from conventional energy markets, and that the benchmarks in the SCM Agreement should be applied accordingly. This suggests some deference to government policies to ensure that, despite the cost gap, a viable clean-energy market can operate. However, the AB decision leaves open many questions, including how to apply the key concepts of the SCM Agreement, “financial contribution,” “benefit,” and “specificity” to the distinctive features of clean-energy markets.

The case for policy space for clean-energy policies has largely to be made in terms of the political and other challenges of adopting ideal or optimal policies to ensure that the relative pricing of clean and dirty energy reflects climate and other environmental externalities. Economists such as Joseph Stiglitz have argued that a general carbon tax is the rational way of doing this. In addition, price distortions have often resulted from past, and in some cases, present subsidization of dirty energy. There is a very limited logic to giving policy space for clean-energy incentives or support to WTO Members who undermine the sought-after environmental benefits by, at the same time, continuing to subsidize dirty energy. While such subsidies have been viewed as politically necessary, and also as a matter of wealth-redistribution, more governments are finding the resolve to reform them (Morocco, Indonesia, and Sudan are recent cases, and India may be soon). In the case of domestic content requirements, while infant-industry arguments might apply to justify them on economic principle in certain cases, many of the industries in question are now well established. While such requirements may have been a political necessity to get enough backing for the initial policy package, it does not follow that they remain a political necessity, now that the clean-energy market is up and running.

PROBLEM/OPPORTUNITY

The uncertainty and potential market instability from spiraling trade disputes concerning clean-energy policies creates a pressing need, but also an incentive, for the major existing players in clean-energy markets to facilitate clarification and evolution of SCM norms to provide secure policy space for clean-energy initiatives that are justified by climate and other environmental objectives, as well as arguably energy security concerns.

At the same time, it is unlikely that a consensus could be found among WTO Members simply to carve out clean-energy policies from SCM disciplines altogether. There was originally a category of non-actionable subsidies in the SCM Agreement, which expired and was never renewed, reflecting considerable disagreement about the need or desirability for such a category. Again subject to valid infant-industry concerns in the case of developing countries, however politically useful in gaining support for clean energy, domestic content requirements and other discriminatory measures actually undermine environmental objectives by shifting production to higher-cost jurisdictions, and therefore making clean energy, or clean-energy technologies, more expensive than they need to be.

It is notoriously difficult to obtain agreement on amending existing WTO treaties, especially outside a trade round. Members are focused on an effort to achieve results on Doha that have been long delayed. The issue of policy space under the SCM Agreement could conceivably be added to the Environmental Goods and Services (EGS) negotiations. While this is an area that has been particularly paralyzed, the Obama administration has announced that it will take the initiative to bring concepts from the Asia-Pacific Economic Cooperation (APEC) agreement in this area to the WTO negotiating forum, in an effort to re-energize the EGS talks. It is hard to imagine how one would avoid getting SCM reform with respect to clean energy entangled with the negotiation on “rules” reform more generally.

For these reasons, the concrete options to be addressed in the section of the paper that follows will focus on alternatives that do not require formal amendment of the SCM Agreement, although this may be the longer term result. Perhaps here the trajectory of the access to medicines arrangements with respect to the Trade-Related Aspects of Intellectual Property Rights (TRIPS) is a useful precedent. The opportunity of focusing on agreement on the interpretation and application of the SCM Agreement rather than its amendment arises, at least in part, from the notoriously open-ended (some scholars would say ambiguous or, at least, economically incoherent) nature of the key concepts for determining whether subsidies are susceptible to challenge under the SCM Agreement, or susceptible to WTO legal trade remedy action. In addition, as

already noted in the *Canada–Renewable Energy* case, the AB has suggested that there is some real flexibility under the SCM Agreement for governments to take measures to establish and ensure the viability of clean-energy markets, but has left open many questions about the exact contours of that flexibility.

At the present juncture, many clean-energy policies, including incentives, are undergoing reconsideration and reform in light of experience to date, the rapidly evolving technological and commercial realities of clean-energy markets, and fiscal pressures. At the same time, new initiatives are being introduced by, among others, major players such as India and China. This leads to another opportunity—the possibility of finding policy space for existing, arguably non-conforming measures through a time-limited conditional waiver.

RESPONSES: AN INTERPRETIVE UNDERSTANDING ON THE SCM AGREEMENT

Conceiving, at least in the short and medium term, the adjustment of the SCM Agreement through an interpretive understanding rather than an amendment makes sense for the following reasons.

- Experience with attempts at one-off amendments suggests that it would be politically difficult to detach a particular project for amending the SCM Agreement to deal with clean energy from the thorny issue of rules reform more generally.
- There remains an obsessive focus on Bali/Doha at the diplomatic and negotiating levels in the WTO.
- An amendment to a covered agreement can only be done through consensus among WTO Members, which is always hard to obtain.
- An interpretive understanding could be promulgated at the Committee level of the WTO and still have considerable weight in dispute settlement (as was the case, for example, for Technical Barriers to Trade (TBT) Committee norms on international standardization in the Tuna II AB decision).
- Alternatively, an interpretive understanding could be initiated as an open plurilateral agreement, starting with WTO Members who have the most at stake in production and consumption of clean energy.

AN INTERPRETATIVE UNDERSTANDING TO PROVIDE THE NEEDED FLEXIBILITY: ALTERNATIVE APPROACHES

Approach 1: Apply Article XX of GATT

In the *China–Publications* case, the AB raised the possibility that in some circumstances GATT provisions might continue to apply so as to protect the “right to regulate” under some other more specialized agreement (in that case, the Chinese protocol of accession). This would only be the case, however, the AB suggested in *the China–Raw Materials* case, if there was a textual “hook” that related the provision in question to the GATT.

Respected scholars disagree on whether, as a matter of the law as it stands, Article XX applies to the disciplines in the SCM Agreement. Several provisions of the SCM Agreement appear to suggest that the legal status of a subsidy and/or action against subsidies would be determined by applying the GATT and the SCM Agreement together (for example, 25.7). An interpretative understanding would be a legitimate way of resolving the ambiguity.

An advantage of the Article XX route is that of certainty. Through cases such as *EC–Asbestos*, and especially *Brazil–Retreaded Tyres*, the AB has charted a route to considerable policy space for legitimate non-protectionist measures with, among other things, health and conservation objectives (Articles XX [b] and [g]). An interpretive understanding would reinforce the dicta suggested in *Brazil–Retreaded Tyres* that climate change policies would fall within the objectives of these provisions. The chapeau of Article XX offers tested safeguards against abuse of policy space.

An advantage of an Article XX approach is that, especially under XX (b), a Member would have to establish the “necessity” of any trade-restrictive impact from the subsidy. A Member that continues to subsidize dirty (fossil-fuel) energy might well have a difficult time justifying its measure as necessary under Article XX, as there is the less trade-restrictive alternative of changing the relative pricing of clean and dirty energy through the removal of subsidies to dirty energy. The understanding could specify that Article XX should not be interpreted so as to make available policy flexibilities on renewable energy to Members who are unwilling to undertake other reasonably available measures to achieve their objectives, in particular Members who are unprepared to reform or remove, in an appropriate manner, subsidies that distort energy prices in favour of dirty energy.

A disadvantage is that there may be Members who are prepared to grant policy flexibility on clean energy subsidies who would not want Article XX to be understood to be applicable to the SCM Agreement as a general matter. This might be solved by limiting the understanding to energy

or climate-directed measures, but would that approach be coherent, or seen as such by the AB?

Approach II: Define or Clarify the Concepts of "Benefit," "Financial Contribution," and "Specificity" in the SCM Agreement as they Apply to Clean-Energy Subsidies

For a subsidy to be challenged in WTO dispute settlement or targeted with countervailing duties by a WTO member, it must be established that there is a financial contribution by government, that there is a benefit conferred, and that the subsidy is "specific." All three requirements must be met. An interpretive understanding could focus on ensuring that each of these requirements is read in such a way as to respect the need for policy space for legitimate measures aimed at increasing the use of clean energy for climate mitigation and other important public interest reasons.

Specificity

Article 2.1 of the SCM Agreement reads in relevant part,

Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. The criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification.

(c) If, notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy. In applying this subparagraph, account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority, as well as of the length of time during which the subsidy programme has been in operation.

An interpretive understanding could delineate what would be acceptable as "objective criteria or conditions" in the case of clean-energy subsidies. This would be based, in the first instance, on recognizing that increasing the use of clean energy relative to energy that contributes to climate change and to other environmental and health problems is a legitimate objective of subsidy policies in this area. As an indicative matter, illustrative lists might be developed of design features and operational practices that should be presumed to be consistent with the language "objective criteria and conditions" and others that are likely to be

problematic, under the first and/or the second paragraph reproduced above.

Financial Contribution

There is considerable uncertainty and debate about whether and in what circumstances feed-in tariff schemes for clean energy constitute a "financial contribution" by government. There are at least two kinds of situations—one is where the government requires that private operators purchase clean energy at a price higher than that for dirty energy, and another is where the government itself is involved in the purchase of the energy, which could be for delivery through a state monopoly or state enterprise or for resale to private actors (where the government is playing the role of market operator, as was the case in the *Canada–Renewable Energy* dispute).

In addressing the relevant provisions of the SCM Agreement (particularly on "price" support, providing goods and services other than general infrastructure or purchasing goods, and entrusting and directing private bodies), an interpretive understanding might include the following principles.

- Because of differences in environmental externalities, among others, clean energy and fossil fuel-generated energy are not like products or services.
- Measures that address the relatively higher cost of generating clean energy should be presumed not to provide a financial contribution to clean-energy market actors unless they are shown to be in a quantity greater than that required to address fully the higher cost of clean-energy generation relative to fossil-fuel generation.
- Likewise, such measures shall be deemed not to provide "price support" within the meaning of Article 1 of the SCM Agreement.

Benefit

Here the interpretive understanding could build on the AB decision in *Canada–Renewable Energy* and might include interpretive principles along the following lines.

- The determination of "benefit" under the SCM Agreement requires a comparison against an appropriate market benchmark. Clean-energy markets have different characteristics than conventional-energy markets. This must be taken into account in choosing an appropriate benchmark.
- In order to confer a "benefit," a challenged measure would have to provide a competitive advantage to the beneficiary over other participants in the clean-energy market.
- Measures targeted at addressing the cost difference between producing clean energy and conventional energy

should be presumed not to confer a benefit, unless the magnitude of the financial contribution is significantly out of proportion to this goal.

Domestic Content Requirements

- It is often claimed that domestic content requirements are necessary for gaining political support for incentives and other measures to support clean energy. This may have been true at some point, but it may no longer be true, especially where the programs in question are now well established and have constituencies supporting them for other reasons.
- Domestic content requirements are unambiguously prohibited under the SCM Agreement and Article III: 4 of the GATT.
- Flexibility for new measures of this kind could conceivably be found in the case of developing countries through interpreting the infant-industry provisions of the GATT (Article XVIII: C as applicable to the SCM Agreement), on a similar theory as that discussed above in relation to Article XX.
- An interpretive understanding could facilitate the conversion of SCM-inconsistent domestic content requirements into other kinds of WTO-consistent measures that ensure that recipients of clean-energy subsidies provide benefits to the local economy. It could be affirmed that conditions such as training or hiring of local workers, and technology transfer (subject to any specific TRIPS disciplines) should be presumed to be consistent with the GATT, Trade-Related Investment Measures (TRIMs), and the SCM, provided they do not discriminate against imports or violate most favoured nation (MFN) norms.

WAIVER

An alternative, or perhaps even a complement, to an interpretive understanding could be a waiver for existing clean-energy policies pursuant to Article IX (3) of the WTO Agreement. Waivers have been not infrequently used to deal with new challenges. A recent example is the waiver for measures to implement the Kimberly Accord on conflict diamonds.

- A waiver must be time-limited and may be subject to terms and conditions.
- A disadvantage of a waiver is that, as a matter of WTO practice, it must be enacted by consensus whereas, as noted above, an interpretive understanding could take the form of an open plurilateral agreement.

- A waiver, on the other hand, has the advantage of providing a high degree of legal certainty and security with respect to a defined set of policies, a genuine "safe" policy space.

THE POSSIBLE CONTENT OF A WAIVER

- Policies could be defined in terms of objectives (climate mitigation, addressing environmental externalities more generally), and design (supporting clean-energy markets, shift from dirty energy to clean energy, and so on).
- The waiver could be conditioned on removal of discriminatory aspects of policies within a set, relatively short time-frame (for example, domestic content requirements).
- The waiver could also contain an Article XX chapeau-like provision requiring that policies under the waiver not be applied in a manner that constitutes arbitrary or unjustifiable discrimination.
- To benefit from the waiver, a WTO Member could be required to make a notification of the policies in question, and provide a detailed plan about removal of discriminatory aspects within a defined time-frame.
- To benefit from a waiver, a WTO Member could be required to eliminate or reform other policies that undermine the objectives on the basis of which the waiver is given, in particular, fossil-fuel subsidies.

THE PROBLEM OF TRADE REMEDIES

- An interpretive understanding of the kind sketched above would only partly address the threat to policy space from proliferating trade remedy actions against clean-energy products. It would certainly not address anti-dumping actions.
- A recent Cato Institute study (Lester and Watson 2013) has suggested that, as part of a US-led initiative on liberalization of trade in environmental goods and services at the WTO, listed environmental goods would be completely exempted from trade remedy actions. This is a desirable long-term goal. It would likely entail changes in domestic legislation, depending on the jurisdiction.
- Some scholars, such as James Wu and Salzman from Harvard Law School, believe that these kinds of reforms are inherently politically infeasible. However, as some of the recent disputes have illustrated, there are also domestic constituencies that are against imposition of trade remedies, such as users of the products in question

as inputs. A game-changing proposal on exemption from trade remedies could give additional power to those constituencies.

If the waiver alternative discussed above were adopted, there could be an agreement not to take trade remedy action against any policy covered by the waiver during the period of the waiver's validity, provided the conditions of the waiver are fully met. Disputes about whether those conditions are met, for purposes of determining whether trade remedy action is permissible, could be stipulated to be subject to arbitration under the Dispute Settlement Understanding (DSU).

More gradualist options could include the following measures.

- An undertaking by willing WTO Members to engage in consultations as soon as they are aware that policies and practices by another Member may give rise to a trade remedy action in their jurisdiction ("early warning").
- An interpretative understanding that positive environmental and other impacts in the importing country of the policies and practices being responded to by trade remedies be netted out when injury is determined.
- An interpretative understanding that a fair price comparison within the meaning of Article 2.4 of the anti-dumping agreement take into account distortions in domestic and global energy markets that make it difficult or impossible to properly compare prices using any of the methodologies prescribed in the Anti-Dumping Agreement.
- A commitment to publish an objective study of the costs and the benefits of the measures being responded to by trade remedy action as well as the trade remedies themselves. To the extent possible, this would include costs and benefits in the case of both the importing and exporting countries, as well as global costs and benefits, including environmental costs and benefits.

CONCLUSIONS

- The immediate, short- and medium-term focus should be on alternatives to formal amendment of the SCM Agreement.
- Neither environmental nor economic objectives are served by a carve-out approach of removing clean-energy policies from WTO disciplines altogether, especially non-discrimination, even if historically, discriminatory policies like domestic content requirements have been part of a political bargain to get clean-energy markets up and running.
- Whether the chosen alternative is an interpretive understanding or a waiver (or both), policy space should be conditioned on the elimination or reform of other policies that undermine the objectives for which policy space is being granted, in particular fossil-fuel subsidies.
- Protecting policy space against trade remedy action is a particularly difficult challenge politically. But there are important domestic constituencies in many instances whose interests are harmed by such action. Proposals that contain trade remedy action may not in the short term have political success in the WTO, but they may have a dynamic effect on the salience of anti-trade remedy constituencies.
- Approaches to policy space should work with trends to reform and redesign clean-energy subsidies for non-trade law reasons, and not provide a shield for those resisting reform.

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